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Report to the Chairman, Subcommittee
on Investigations, Committee on Armed
Services, House of Representatives

January 1990

FOREIGN MILITARY SALES

Defense Efforts Are Improving Program Accounting



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Accounting and Financial
Management Division

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January 17, 1990

The Honorable Nicholas Mavroules
Chairman, Subcommittee on Investigations
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

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Our previous report entitled, Foreign Military Sales: Redirection of Accounting Improvement Efforts Is Appropriate (GAO/AFMD-88-75, September 15, 1988), concurred with the Department of Defense's (DOD) proposed efforts to address long-standing foreign military sales (FMS) accounting problems. These efforts included the development and implementation of a new central FMS accounting and billing system and the establishment of a second FMS trust fund. In response to that report, the former Subcommittee Chairman requested that we evaluate DOD's progress in implementing these improvements.

After meeting with your office, we agreed to take a three-step approach in responding to this request. First, we agreed to evaluate (1) DOD's efforts to enhance the current FMS accounting and billing system, (2) DOD's progress in resolving the differences between billing and disbursement records in the current trust fund, and (3) DOD's planned implementation of a second FMS trust fund to isolate the errors associated with existing sales and provide a "clean slate" for newly initiated sales. Second, we agreed to evaluate the Department of the Air Force's progress in developing a new FMS accounting and billing system. Third, we agreed to monitor this system development effort and periodically brief the Subcommittee staff. This report discusses the first of these efforts. Subsequent reports will be issued to respond to the other segments of your request.

We found that DOD has implemented two system enhancements, referred to as case level disbursements and positive transaction control, to (1) facilitate the identification and timely resolution of differences between the disbursement and billing records associated with FMS cases and (2) help ensure the accurate and complete recording of FMS data. The Air Force Audit Agency is currently testing these system enhancements. The Air Force will need to correct any system weaknesses identified through the testing.

We also found that DOD has made progress in reconciling the differences between disbursement and billing records. The reconciliation efforts have reduced the net differences from \$229 million in December 1987 to \$67 million as of August 1989. In June 1989, the Deputy Secretary of Defense postponed the implementation of the second FMS trust fund because the planned implementation would not have segregated activity associated with new FMS cases from those in the existing trust fund. The Air Force was directed to develop a plan to establish a second trust fund independent of the existing trust fund. The Air Force submitted its plan to the Deputy Secretary of Defense on November 17, 1989.

Background

The Arms Export Control Act (22 U.S.C. section 2751 et seq.) gives the President authority to sell defense articles and services to eligible foreign countries and international organizations, generally at no profit or loss to the U.S. government. The act generally requires foreign customers to pay, in advance, amounts sufficient to cover costs associated with their sales agreements. DOD then uses the funds, held in trust by the Department of the Treasury, to pay private contractors and to reimburse DOD activities for the cost of executing and administering FMS agreements.

As of September 30, 1989, there were over 17,000 open FMS sales agreements—commonly referred to as sales cases—valued at about \$156 billion.¹ This included undelivered goods and services valued at around \$62 billion. For fiscal year 1989, new orders totaled approximately \$10.5 billion.

The Defense Security Assistance Agency (DSAA) has overall responsibility for administering the FMS program. Generally, the Army, Navy, and Air Force execute sales cases. The military services report detailed disbursing and accounting data to a central activity—the Security Assistance Accounting Center (SAAC)—which maintains the records of each country's trust fund balance and issues periodic statements to foreign customers summarizing amounts charged to their sales cases.

For more than 10 years, GAO and DOD auditors have reported major accounting and internal control weaknesses impairing DOD's ability to properly manage the FMS trust fund and provide accurate statements to

¹These 17,000 FMS cases are designated open because portions of their transactions are incomplete; that is, delivery of materiel, performance of services, completion of financial transactions, or rendering of the final statement of accounts has not occurred.

customers. These weaknesses included (1) inadequate internal controls over the accuracy of data the military departments submit to the central accounting system maintained by SAAC and (2) an inability to reconcile country level trust fund balances with the detailed balance of each country's sales cases. As a result, old discrepancies remain unresolved while new errors continue to occur, and complete reconciliations are difficult, if not impossible, without an extraordinary amount of research. Our June 1987 and March 1988 testimonies² describe these weaknesses in detail and provide specific examples of their effects on the accuracy of FMS accounting records.

Furthermore, OMB recently identified the foreign military sales program on its list of "high risk" areas in the federal government. OMB stated that FMS' long-standing problems are primarily related to financial systems and unreconciled balances between disbursement from the FMS trust fund and deliveries made to FMS customers. Thus, there is no assurance that all applicable costs are charged to the customers.

In 1982, after 6 years of unsuccessful efforts to improve central FMS accounting, DOD established the FMS Financial Management Improvement Program under the Defense Comptroller. Under the program office's direction, DOD initiated a comprehensive plan to correct past deficiencies. A new central accounting system, which also included the development of interfacing systems in each military service, was the centerpiece of this plan.

In July 1988, the former Deputy Secretary of Defense redirected DOD's efforts to improve the financial management of the foreign military sales program. The Deputy Secretary mandated the immediate termination of the central accounting system development effort because the project had substantially exceeded cost and schedule estimates without achieving systemwide capability. As a result, the Deputy Secretary of Defense appointed the Air Force as the executive agent to design, develop, implement, and operate a new central FMS accounting and billing system. The Deputy Secretary also directed the establishment of a second FMS trust fund by October 1989.

²DOD's Financial Management of the Foreign Military Sales Program (GAO/T-AFMD-87-12, June 4, 1987) and Status of DOD Efforts to Improve Accounting for Foreign Military Sales (GAO/T-AFMD-88-9, March 31, 1988).

Objectives, Scope, and Methodology

The objectives of our review were to evaluate DOD's efforts since July 1988 to (1) enhance the current FMS accounting and billing system, (2) resolve differences between billing and disbursement records in the current FMS trust fund, and (3) establish a second FMS trust fund.

To address our objectives, we interviewed representatives of the Departments of the Navy and the Air Force, the Defense Security Assistance Agency, and the DOD Office of the Comptroller in Washington, D.C.; the Department of the Army in Indianapolis, Indiana; and the Security Assistance Accounting Center in Denver, Colorado.

We obtained a copy of the November 1988 plan outlining DOD's methodology for implementing the second trust fund and the system enhancements needed to facilitate this implementation. We discussed the actions taken by DSAA, SAAC, and the military departments to test and implement the planned system enhancements. We did not evaluate the system enhancement efforts because the Air Force Audit Agency is in the process of conducting comprehensive tests of them. They anticipate completing this system testing by January 1990.

We also reviewed the SAAC quarterly reconciliation reports to document the reported differences between the disbursement and billing records for the FMS program. Further, we obtained and reviewed the reconciliation progress reports prepared by SAAC and the military departments to ascertain the specific actions they had taken or planned to initiate in order to resolve the differences between the disbursement and billing records.

We also reviewed reports prepared by GAO, the DOD Inspector General, and congressional committees to ascertain which specific internal control and accounting system problems had been previously identified and whether corrective actions initiated by DOD adequately addressed the problems. We conducted our review between December 1988 and August 1989 in accordance with generally accepted government auditing standards. We discussed the results of our review with Defense officials and incorporated their comments where appropriate.

System Enhancements Address Fundamental Weaknesses

To more accurately account for and control the FMS program, DOD implemented two system enhancements: case level disbursements and positive transaction control. As we stated in our September 1988 report³, incomplete and inaccurate data was transmitted from the military departments and recorded in the central FMS system. This adversely affected the reliability of FMS accounting data and the reconciliation of discrepancies in customer accounts. Recognizing the need to improve the integrity of the FMS data, DOD decided to implement these controls as part of its efforts to implement the second trust fund rather than waiting for the new FMS accounting system to be developed and implemented. The Air Force Audit Agency anticipates completing its testing of these enhancements by January 1990.

Case Level Disbursements

Prior to the implementation of case level disbursements, the central accounting system maintained billing and disbursement records at different levels of detail. The billing records were recorded on a country and case level, while disbursements were recorded only on a country level. Therefore, when a discrepancy between the two sets of records occurred, SAAC could not readily reconcile the disbursing and accounting transaction that caused the difference. As of March 1989, disbursement data are recorded at the case level, which enables the military services and SAAC to have comparable data on each sales case. This control is expected to assist SAAC and the military services in identifying and reconciling differences in individual case records.

Positive Transaction Control

Prior to the implementation of positive transaction control, the central accounting system operated by SAAC did not include adequate internal controls to identify or prevent errors and ensure that rejected data transactions were promptly corrected and reentered into the system. We previously identified⁴ the following system weaknesses:

- System checks on the quality of data were nonexistent or inadequate. Data were not subjected to standard checks or edits before they were submitted to SAAC, and edits within SAAC's system were designed to speed processing rather than ensure accuracy.
- SAAC did not control transactions rejected by the accounting system to ensure that they were promptly corrected and resubmitted.

³See page 1.

⁴DOD's Financial Management of the Foreign Military Sales Program (GAO/T-AFMD-87-12, June 4, 1987).

Positive transaction control, which was implemented in October 1988, edits and validates data transmitted by the military departments prior to processing the data into the central accounting system. Positive transaction control will reject transactions failing the edit criteria and post them to a suspense file for correction by the appropriate service. The implementation of positive transaction control is expected to give SAAC more accurate and timely information on FMS cases.

Progress Is Being Made in Reconciling Billing and Disbursement Records

The military departments and SAAC are making progress in resolving the differences between the billing and disbursement records. Under the direction of DSAA, DOD organized a working group to coordinate this reconciliation. This working group is comprised of DSAA, SAAC, and the military departments. The group's efforts have concentrated on the reconciliations of

- cash deposits, by country, since the establishment of the centralized accounting system in 1980 and
- the disbursements and related billing for specific out-of-balance cases.

According to SAAC records, as of August 1989, the total unreconciled difference between billing and disbursement records was \$247 million with a net unreconciled difference of \$67 million; by contrast, the total difference as of December 1987 was over \$1 billion with a net difference of \$229 million.

Cash Deposits Reviewed

The working group's initial effort was to review cash deposit data for each country. As of June 1989, SAAC had reviewed all cash transactions posted since the current accounting system was implemented in 1980. SAAC reviewed all deposits from customer countries to ensure that they were accurately recorded and that each service had an accurate cash balance for each country. Thus, each service had the baseline information needed to trace the amount of disbursements made for each foreign country. When a service identifies a correcting entry for its own FMS records, SAAC is to make a corresponding adjustment to its records. According to SAAC, cash transactions for earlier FMS cases will be reviewed by March 1990.

Out-Of-Balance Conditions Are Being Reduced

The military services are currently reconciling differences between dollar amounts that have been spent from the FMS trust fund with the cost of deliveries reported to the customers. SAAC's verification of cash

deposit data has assisted the military services in their review of individual case records and the resolution of out-of-balance conditions.

Each military service manages the individual sales cases and reports transactions, such as performance (delivery of goods and services) and the disbursement of cash, to SAAC. In addition, resolving the differences between billings and disbursements for an individual case and preparing the resulting adjustments are ongoing functions of each service's FMS case management. Reconciliation efforts of the services include the following.

- Army officials stated that they compared billing and disbursement information transmitted from the Army to SAAC. This effort involved matching the reported disbursements from status reports to actual case files. An Army Finance Center representative stated that for specific Saudi Arabia cases they identified about \$8.3 million that should have been reported as a DSAA disbursement for Saudi Arabia but was erroneously reported as an Army disbursement. By correcting the accounting records, the overall effect of the DOD out-of-balance condition for Saudi Arabia was reduced by about \$3.3 million. This effort also identified another \$29 million that should have been reported as an Army disbursement rather than a DSAA disbursement.
- In October 1987, the Air Force assumed the accounting and reconciliation responsibility for all Air Force FMS cases. Prior to this time, these responsibilities were split between SAAC and the Air Force. An Air Force representative stated that centralizing the accounting for Air Force cases has consolidated controls for accounting and reporting, which facilitates reconciliation of FMS cases. As part of this reconciliation effort, Air Force identified a total of \$562 million of disbursements and adjustments erroneously recorded in its accounting system. The Air Force corrected these disbursements and made the appropriate adjustments after it researched these cases and found the necessary supporting documentation. According to an Air Force official, these accounting adjustments most likely would not affect the total cash balance; however, they resulted in correcting individual country and case accounting records.
- The Navy's reconciliation efforts included comparing the disbursements reported to SAAC with Navy source documents. One comparison identified 100 valid case disbursements valued at about \$25 million that did not identify the specific country and case the disbursement should have been applied to, due to a system interface problem. According to Navy

officials, this problem has been corrected. At the January 1989 reconciliation meeting, the Navy reported that its reconciliation of disbursements had identified \$60 million of disbursements previously not reported and corrected \$47 million of erroneously reported disbursements. The Navy has also initiated other reconciliation activities. It is in the process of having FMS accounting data currently stored on microfiche transferred to computer diskettes. This transfer of archived data will assist in comparing actual disbursements for FMS cases to reported disbursements.

DSAA, SAAC, and the military services face a difficult challenge in reconciling the remaining \$67 million in differences between billing and disbursement records. To date, the reconciliation efforts have centered on activity that occurred since the establishment of SAAC in 1980. The remaining reconciliation efforts, however, must address errors that pre-date 1980 and may well have occurred 10 to 15 years ago. Supporting documentation may no longer be available.

If SAAC and the military service are not able to completely reconcile specific differences, the related cases are to be forwarded to the Reconciliation and Case Closure Board. According to its charter, the Board's primary purpose is to examine unreconcilable imbalances in individual cases and determine what action—such as additional billings to customer countries—should be taken. The Board members consist of the DSAA Comptroller, DOD's Director of Accounting Policy, and a representative of the military service involved in the case under review.

The Board's decisions must be completely documented because they could result in the expenditure of government money to cover any disbursement of customer funds that cannot be supported by billing records. In these cases, DOD may have to request additional funding from the Congress. Conversely, if the Board's decisions result in additional billings to the foreign countries, the Board must be able to fully support those billings.

A Reports and OMB Identified FMS Weaknesses

Reconciling the differences between DOD's foreign customer billing records and trust fund disbursements has been a long-standing problem and has precluded DOD from providing an accurate accounting for FMS customer funds. In their fiscal year 1988 Federal Managers' Financial Integrity Act⁵ (FIA) report, the military departments identified the following FMS accounting weaknesses:

- The Army attributed its problem to the lack of positive transaction control. As a result, its logistical and financial records are not in agreement and SAAC's and the Army's records are not in balance. An Army Finance Center official stated that, to help alleviate this problem, the Director of Finance and Accounting issued a policy letter in June 1988 requiring that each case manager be responsible for (1) the accuracy of the accounting and logistical data for the assigned case and (2) initiating the necessary actions to ensure that all errors receive prompt clearance. Prior to this, the case manager was only responsible for the accounting data.
- The Air Force recognized that, as a result of its inability to resolve the differences between its billing and disbursement records, the Congress might have to supplement the FMS trust fund. The Air Force's corrective action plan centers on the implementation of the case level disbursement and positive transaction control system enhancements previously discussed.
- The Navy identified weaknesses in the timeliness and usefulness of information produced by the system; inadequate system interfaces, hardware and software, and reporting; and overall systems control problems. To correct these problems, the Navy implemented a new FMS system in October 1989. A Navy official stated that the DOD Office of Accounting Policy has identified some system weaknesses. As a result, the Navy Finance Center internal auditors are planning an audit of the system in early 1990.

Because of the significant dollars involved and the long-standing nature of the problems in the FMS program, we believe it is appropriate for the respective military departments to continue to report this problem in their annual Financial Integrity Act reports.

⁵The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. section 3512(b) and (c)) gives agency management the primary responsibility for maintaining adequate systems of internal control and accounting. The act requires agency heads to report annually to the President and the Congress on the status of these systems, and it holds managers responsible for correcting identified deficiencies.

OMB has also recognized FMS weaknesses. As mentioned previously, OMB has recently included FMS on its list of "high risk" areas in the federal government. Because of this action, the Deputy Secretary of Defense will be required to pay special attention to the FMS area. For example, the Deputy Secretary is to receive reports at least quarterly that highlight and explain the progress or delays in correcting FMS' problems. Furthermore, OMB requires that the Department of Defense's budget identify efforts being made to correct the problems so that adequate resources can be allocated for those efforts.

Implementation of the Second Trust Fund Delayed

In June 1989, the current Deputy Secretary of Defense postponed the establishment of the second trust fund. He took this action because the fund could not be implemented as originally intended by the October 1989 deadline that the former Deputy Secretary of Defense set in his July 1988 memorandum.

DOD's Director of Accounting Policy stated that the purpose of the second trust fund was to segregate activity associated with new FMS cases from those in the existing trust fund. In this way, the unresolved discrepancies in cases in the current trust fund would be isolated from the balances related to new cases. As a result, DOD would be better able to (1) research and resolve discrepancies in the current trust fund, (2) avoid the creation of discrepancies for new cases, and (3) reconcile country level trust fund balances. However, instead of creating a separate trust fund, DOD planned to use the current trust fund as a "carrier account." That is, DOD was planning to process all FMS transactions through the existing trust fund and only record in the second trust fund those transactions that were free from error. Because new case transactions with errors would remain in the current trust fund until corrected, the plan to use the second trust fund to segregate all new case activity for additional control purposes would not be met. As a result, any discrepancies from new cases would be added to those already in the existing trust fund.

According to Air Force officials who participated in planning the implementation of the second trust fund, the carrier account approach was selected due to the limited time allowed for this implementation. DOD had about 15 months from the time of the Deputy Secretary's memorandum in July 1988 until October 1989. During the initial 4 months, DOD examined alternative approaches. In November 1988, it was estimated that implementing the second trust fund as intended would require about 14 months, which exceeded the October 1989 time frame by

3 months. These extra months were deemed necessary due to the complexity involved in changing DOD's multiple financial and logistical systems to adequately account for a second trust fund. Therefore, Air Force officials told us that using the current trust fund as a carrier account was seen as the most feasible way to implement the second trust fund in the remaining 11 months. This plan also identified the previously discussed system enhancements that would facilitate implementation of the second trust fund and address fundamental weaknesses affecting the reliability of FMS data.

The DOD Inspector General's examination of the second trust fund's implementation plan concluded that the carrier account approach would not achieve the intent of the second trust fund. We agree with this assessment. In June 1989, the Deputy Secretary of Defense issued a memorandum postponing the implementation of the second trust fund. This memorandum specified that the Air Force, as executive agent, had 120 days to develop a viable plan to establish a second trust fund independent of the existing trust fund. The plan was submitted on November 17, 1989.

Some service representatives believe that the newly implemented system enhancements—case level disbursements and positive transaction control—may preclude the need for a second trust fund. They believe these enhancements will reduce the potential for the types of errors that created unreconciled discrepancies and that it will enable reconciliation of country level trust fund balances.

The results of the Air Force Audit Agency's comprehensive test of these enhancements should indicate if case level disbursements and positive transaction control are working as intended and are addressing the system weaknesses previously identified and reported upon by GAO and the DOD Inspector General. The testing results may also identify issues that DOD will need to address in order to improve the accounting and billing for the foreign military sales program.

Conclusions

DOD has implemented enhancements to the central FMS accounting system that are intended to improve FMS accounting. Until now, the services and SAAC were maintaining data at different levels of detail, which has precluded an accurate accounting to the foreign countries and hindered the reconciliation process. The case level disbursement and positive transaction control enhancements to the central accounting system

should help ensure that central FMS records are accurate and that discrepancies between disbursement and billing records are promptly identified and corrected. To do so, DOD needs to ensure that the reconciliation efforts remain an integral part of improving the FMS accounting data.

DOD's decision to postpone the implementation of the second trust fund was appropriate because the planned implementation of the second trust fund would not have segregated activity associated with newly initiated FMS cases from the cumulative balances associated with cases in the existing trust fund. The Air Force was directed to develop a plan to establish a second trust fund, in accordance with the intent of the July 1988 memorandum. As part of this process, the Air Force was also to determine the need for a second trust fund.

The Air Force Audit Agency is in the process of evaluating the case level disbursements and positive transaction control enhancements. The system testing may identify issues that need to be corrected. To improve the overall accounting for the Foreign Military Sales program, we believe the Secretary of the Air Force will need to correct any system weaknesses identified by the Air Force Audit Agency's current system testing.

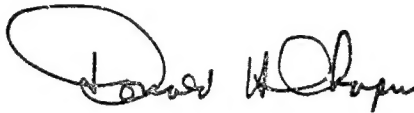
We are not making any recommendations at this time. However, as part of our ongoing work for the Subcommittee, we will continue to monitor DOD's efforts to improve FMS accounting. Specifically, we will monitor whether

- DOD's top management continues to focus attention on the reconciliation efforts,
- DOD takes action to correct the system weaknesses identified by the Air Force Audit Agency's current testing of the FMS system, and
- the decisions of the Reconciliation and Case Closure Board are supported by adequate documentation.

As requested by your Subcommittee, we did not obtain written agency comments on a draft of this report. However, the results of our review were discussed with responsible agency officials and their comments were incorporated where appropriate. We are sending copies of this report to the Secretary of Defense; the Secretaries of the Air Force, Army, and Navy; the Director of the Defense Security Assistance Agency; and the Director of the Security Assistance Accounting Center. Copies will also be made available to others upon request.

This report was prepared under the direction of Jeffrey C. Steinhoff, Director, Financial Management Systems Issues, who may be reached at (202) 275-9454 if you or your staff have any questions. Other major contributors to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Donald H. Chapin". The signature is fluid and cursive, with a large initial "D" and "C".

Donald H. Chapin
Assistant Comptroller General

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